DOCUMENT RESUME

ED 352 439 CE 061 670

AUTHOR Faux, Jeff; Lee, Thea
TITLE The Effect of George Bush's NAFTA on American Workers: Ladder Up or Ladder Down? Briefing Paper.
INSTITUTION Economic Policy Inst., Washington, DC.
PUB DATE 92
NOTE 35p.
AVAILABLE FROM Public Interest Publications, P.O. Box 229, Arlington, VA 22210 ($5).
PUB TYPE Reports - Evaluative/Feasibility (142)

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Adults; Dislocated Workers; *Employment Patterns; Employment Projections; *Foreign Policy; International Cooperation; International Relations; *International Trade; *Labor Economics; Living Standards; Marketing; Trend Analysis; Unemployment; Vocational Education; Wages; World Affairs
IDENTIFIERS *North America; *North American Free Trade Agreement

ABSTRACT

The proposed North American Free Trade Agreement (NAFTA) will result in lower wages, fewer jobs, and generally reduced living standards for the majority of U.S. workers. Substantial costs to the U.S. economy will occur in job and income loss and few off-setting benefits for most workers. Proponents argue that NAFTA will create upward mobility for U.S. workers as low-wage jobs move to Mexico. Available data and past experience show that U.S. workers displaced by trade end up moving down the job ladder to lower-paying jobs or off the ladder to permanent unemployment, not up to better jobs. Most of the conventional studies that have attempted to quantify NAFTA's impact on the U.S. economy have either ignored the shift of investment from the United States to Mexico or have examined only the Mexican side of the equation. The extent to which investment in Mexico replaces investment in U.S. plants clearly will determine NAFTA's overall impact on U.S. jobs. Perhaps the greatest danger to the U.S. economy from adopting NAFTA is that it will encourage U.S. firms to seek a low-wage solution to the challenge of global competition. NAFTA would undercut chances of a "high wage" strategy of investing in the labor force of Mexico or the United States. U.S. interest in a NAFTA should not lie in expanding free trade but in improving living standards for the Nation. (Appendixes include 29 endnotes and 37 references.) (YLB)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

Economic Policy Institute

Briefing Paper

1730 Rhode Island Ave., NW • #200 • Washington, DC 20036 • 202/775-8810

The Effect of George Bush's NAFTA On American Workers: Ladder Up or Ladder Down?

"PERMISSION TO REPRODUCE THIS MATERIAL IN OTHER THAN PAPER COPY HAS BEEN GRANTED BY

C Poff

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

This document has been reproduced as received from the person or organization originating it.

Minor changes have been made to improve reproduction quality.

Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

ED352439

By Jeff Faux and Thea Lee

Introduction

A decision to support or not to support the Bush-Salinas-Mulroney version of a North American Free Trade Agreement has little to do with the abstract arguments about "free trade" and "protection." It has everything to do with the living standards of the people of the United States. If members of Congress are certain that the agreement produced by the current trilateral negotiations will raise incomes and expand job opportunities in the United States, they should accept it. If they are not, if there is any serious doubt, they should reject it. America's working families are already suffering enough loss of income and job opportunity because of past policies based on unexamined economic theories that seemed persuasive at the time. Given that experience, putting their economic future further at risk -- without a high degree of confidence that the outcomes will be favorable -- would represent a betrayal of the public trust.

The issue before us now is not *whether* the United States should trade with Mexico and Canada or *whether* investment should be allowed to move freely within North America. Canada and Mexico are already among our most important trading partners, and — as is evident in all three countries — investment is already quite mobile. The question is *how* increasing trade and investment should take place.

How the North American countries choose to integrate their economies will in some measure define their course of economic development during the next several decades. Two strategies confront us. One is modeled on the European path to integration, which was slow and gradual, sensitive to the disparities of income and social institutions between countries, and committed to achieving integration without penalizing workers. The other is

CE061670

BEST COPY AVAILABLE

the model implicit in the agreement proposed by the Bush, Salinas, and Mulroney Administrations — to remove rapidly all remaining barriers to the flow of capital, goods, and services across North American borders, leaving the fate of U.S. incomes, working conditions, and environmental and social regulation to the economic and political forces that result.

This paper will explore the probable outcomes for the U.S. labor force of the Bush-Salinas-Mulroney North American Free Trade Agreement (NAFTA). Our conclusion is that as presently designed the proposed free trade agreement will harm the United States' long-term economic competitiveness and put in jeopardy the jobs of hundreds of thousands of American workers. It will also put downward pressure on the wages of millions more Americans working in sectors not directly affected by the agreement. A substantial restructuring of the overall agreement will be necessary in order to avoid serious long term damage to the U.S. economy.

* * * *

NAFTA's Impact on the United States

The economic case *for* NAFTA rests primarily on two arguments: first, that NAFTA will expand U.S. jobs because U.S. exports to Mexico will expand; second, that U.S. workers who lose their jobs to imports from Mexico will benefit from better and higher-paying jobs. U.S. Trade Representative Carla Hills, among others, has argued that the free trade agreement will greatly increase U.S. exports to Mexico, and that these increased exports will generate hundreds of thousands of new jobs for U.S. workers. To support this contention, the U.S. Commerce Department released a study in August of 1991 that detailed state-by-state increases in U.S. exports to Mexico (U.S. Dept. of Commerce, 1991). But the study, not untypical of the evidence offered by the Administration in this debate, ignored the other side of the coin: imports. Although U.S. exports to Mexico have risen rapidly since 1986, it is also the case that U.S. imports from Mexico have been rising almost as fast (see **Figure 1**). This occurs because the vast majority of U.S. exports to Mexico are capital goods and components, not consumer goods. These goods are used mainly to produce goods for export back to the United States, not for consumption by Mexican consumers. Total job growth is generated by increases in *net* exports (the excess of exports over imports), not by exports that turn around and come back as manufactured goods a few weeks or months

Figure 1
US Trade with Mexico
1980-1991

Source: International Monetary Fund, Direction of Trade Statistics, June 1992; U.S. and Mexico CPI and exchange rates from International Monetary Fund, International Financial Statistics, June 1992.

later. It is inconsistent to argue, as Ambassador Hills does, that exports create jobs, without recognizing that they also create the capacity for expanding imports, which can cost jobs.

The argument that NAFTA will create upward mobility of U.S. workers is reflected in MIT professor Rudiger Dornbusch's (1991) claim that the free trade agreement with Mexico will focus trade policy on "creating *more* and *better* jobs." The bad (low-wage) jobs will move to Mexico, he argues, while U.S. workers will move up the ladder to the high-paying, high-tech jobs that the agreement will create. No one could be against such a happy arrangement.

But Professor Dornbusch's optimism is belied by the data on our past experience which show that U.S. workers displaced by trade are more likely to move *down* the job ladder, to lower-paying jobs, to move *off* the ladder to permanent unemployment, not *up* the ladder to better jobs than they started with. In a series of studies on displaced workers, starting in 1979 and continuing through 1990, the Bureau of Labor Statistics found that even those workers who were reemployed took large pay cuts and were subjected to long periods of unemployment. During the late 1980s, when the unemployment rate was falling rapidly, the average loss in real weekly earnings was 10 percent for all displaced manufacturing workers who found other employment. (Podgursky, 1991, p. 4). But a large number of displaced workers did not find a new job by the survey date — some were without work for as much as five years after the date they were first laid off. About half of these dropped out of the labor force altogether. In the apparel industry, for example, 48 percent of the workers laid off between 1981 and 1986 had not found new jobs by January 1986. Of those who were not re-employed, 62 percent were no longer in the labor force.[1]

Nothing in the Bush Administration's NAFTA strategy suggests that workers dislocated as a result of this new trade agreement will fare any better than dislocated workers have fared in the past. Moreover, the consensus of long-range public and private forecasters is that growth in the U.S. economy will be considerably slower over the next decade than in the last, suggesting that the fortunes of trade-dislocated workers in the United States will suffer more.

Predicting NAFTA's Impact on Employment in the United States

Proponents of NAFTA claim that their case is bolstered by the results of several studies, many of which are financed by proponents themselves, in which quantitative economic models have predicted gains in income and employment from NAFTA for all three countries. But economic models are only as good as their assumptions. Unfortunately, the assumptions used by these models to generate positive outcomes correspond neither to the reality of current conditions in the United States, Canada, and Mexico, nor to the actual content of the negotiated agreement.

Thus, one can literally choose a study by a technically competent economist to support *any* of the positions in the NAFTA debate — that the agreement will destroy jobs, create jobs, or have no appreciable impact on jobs. And indeed, the estimates range from net job losses in the United States of 900,000 to net job gains of 130,000.[2]

It is difficult for the non-specialist to understand how much systematic bias is built into the typical economic model. The daunting detail and complex methodologies of the models, as well as the academic credentials of the modelers, lend the results unearned credibility in policy debates. Indeed, members of Congress who would be appropriately skeptical about an economist's ability to forecast the interest rate six months ahead have been willing to cast a vote on another, no more qualified, economist's prediction of how the more complicated and unprecedented interaction between three different countries will play out for the unemployment rate in their district or state five years hence.

The most common economic model used to study the impact of trade policy is the computable general equilibrium (CGE) model. CGE models are constructed around the notion of smoothly functioning, textbook-perfect markets. This means that prices adjust so that supply exactly equals demand in every market all the time. Among other unrealistic assumptions, most CGE models assume that the economies of the trading nations under study enjoy full employment and smoothly adjusting labor markets regardless of how trade changes between them.[3] Any impact on employment is limited to instantaneous shifts between industries; anyone losing a job in one industry is automatically and instantaneously re-employed in another. This obviously does not describe reality. Yet, in the debate in the spring of 1991 over whether to put NAFTA on "fast-track," these models — which are incapable of analyzing net job loss for the economy — were commonly cited as "proof" that NAFTA would have no impact on the U.S. unemployment rate. President Bush's May 1st statement to Congress, for example, stated that, "All three major economic analyses done to

date corroborate that the U.S. will benefit from a North American Free Trade Agreement in exports, output and employment" (Response, 1991, p. 1).

Another assumption these models typically make is that NAFTA will result in a huge increase in productive investment by foreigners in Mexico, but none of this will be diverted from investment in the U.S.[4] Given that 63 percent of current foreign direct investment in Mexico comes from the United States, this assumption makes little sense. The result is that the models, not surprisingly, predict that there will be no loss of jobs and income in the U.S. because of a shift of investment to Mexico.

The key objection to NAFTA, of course, is that if investment shifts from the U.S. to Mexico, jobs will be lost in the U.S. and the loss will be continuous and enduring — precisely the problem assumed away by these models. The models thereby make themselves irrelevant to the debate except as propaganda tools.

In February of 1992, the U.S. International Trade Commission sponsored a symposium on the primary economic models used to evaluate the impact of NAFTA on the three North American economies (USITC, 1992a and 1992b). The conference was held in response to professional criticism of studies used by the ITC and others to argue for "fast-track" approval for NAFTA in the spring of 1991. (See Faux and Rothstein, 1991, for example.) Not surprisingly, the ITC concluded that the "studies uniformly demonstrate that all three countries would benefit from a North American Free Trade Agreement, as shown by increases in welfare and real GDP" (USITC, 1992a, p. 6).

This conclusion was predetermined by the assumptions on which the models were constructed. While the ITC survey does represent significantly more breadth than the earlier generation of models, their basic — and objectionable — elements remain intact. "The apparent consensus of CGE models reflects more the current narrowness of the economics profession than any conclusiveness of empirical evidence," one critic testified at an ITC hearing about the CGE models.[5]

All of the models assume a mechanistic preference by consumers for products based on the country in which they are produced. Thus, according to the models' assumptions, American consumers will refuse to buy a cheaper color TV produced by Zenith in Matamoros, Mexico even though it is otherwise identical to a color TV produced by Zenith in Missouri. This assumption is, to say the least, unjustified in an era where international trade is dominated by intra-firm shipments by multinational corporations of products and components with common labels so that it is often impossible to tell where a product has

been made. Yet, this assumption is largely responsible for many of the models' optimistic findings, especially with regard to income and employment gains in the United States and Canada. If one assumes that consumers prefer U.S.-made goods to Mexican-made goods, can identify them, and are willing to pay more for them, it follows that the incentive for corporations to move production to Mexico in order to take advantage of the low wages will be dampened.

It should be noted that the range of change in real gross domestic product (GDP) predicted for all three countries by the models reviewed by the ITC is extremely broad. And at least for the United States, the GDP figures are not particularly striking. At the low end, one model (Almon) actually shows Mexico's real GDP falling as a result of NAFTA, while others (Bachrach and Mizrahi; and Hinojosa and Robinson's second scenario) show U.S. real GDP essentially unchanged. The high-end predictions (for the increase in real GDP brought about by NAFTA) range up to about 11 percent for Mexico and Canada, and only about 2 percent for the United States, with the bulk of the U.S. estimates well under 1 percent.[6]

In fact, the array assembled by the ITC, far from demonstrating an impressive and convincing consensus, demonstrates the opposite. First, the wide and sometimes conflicting range of results between the models and between different scenarios by the same modeler indicates that the results are quite sensitive to small changes in assumptions. Second, while the models appear to contain a tremendous level of detail about the individual economies, it should be remembered that they actually only incorporate the data from a single year. These data must often be adjusted arbitrarily in order to fit the model's equations at the starting date. Finally, this class of models has not performed well in predicting the results of past instances of trade liberalization, such as the Canada-U.S. FTA.[7]

In its summary of the models, the ITC seems almost deliberately disingenuous on the question of capital flows. It declares — somewhat arbitrarily — that they are too small "to have much impact on the U.S. economy, given the relative sizes of the Mexican and U.S. capital markets" (ITC, 1992a, p. vi). But this confuses portfolio investment (in stocks and bonds), with direct investment (in building new factories, for example). While a reduction of one billion dollars in U.S. stock purchases, per se may have only a negligible impact on income or employment in the United States, that same billion dollars would have a significant impact if it represented a decision to close or not to expand production in Milwaukee in favor of producing in Mexico. Since the CGE models do not distinguish

between these two types of capital, they cannot adequately capture the impact of changes in the location of direct foreign investment within North America.

It should be clear from this discussion that the use of CGE modeling to gain insights into the crucial questions raised by NAFTA does not reflect objective academic scholarship. By and large, the models reflect the bias of the modelers, who begin the exercise with the firm conviction that trade is mutually beneficial. The models are constructed to prove the theory upon which they are based. Indeed, when the results disappoint, the parameters are altered and equations changed or dropped until the results appear more "appropriate."[8] No one should be under the impression that this is a scientific inquiry.

Another optimistic estimate of job gains due to NAFTA was recently produced in a book for the Institute for International Economics (IIE), a Washington-based think tank, that has long promoted unrestricted free trade. Authors Gary Hufbauer and Jeffrey Schott give a thoughtful, thorough, and — for the most part — balanced analysis of the background issues surrounding a potential North American Free Trade Agreement. The single element of the Hufbauer-Schott book that has received the most attention from the media, however, has been their prediction that NAFTA will lead to net job gains for both the United States and Mexico. Unfortunately, this figure is one of the book's more speculative creations and is based on a number of rather shaky premises.

Hufbauer and Schott predict that by 1995 the United States will gain 130,000 jobs and that Mexico will gain a little over 600,000 jobs as a result of trade liberalization via NAFTA and the entire package of economic reforms currently being implemented by President Salinas. Real wages in Mexico rise almost nine percent during the six-year time frame of the study and are unchanged in the United States. Hufbauer and Schott call their model (here referred to as the IIE model) an "historical" model, in contrast to the CGE and econometric models. They write that CGE models "contain a huge number of equations and entail many hidden assumptions about unknown parameters" (Hufbauer and Schott, 1992, p. 51).

The IIE report asserts that the combination of NAFTA and Mexico's other economic reforms will attract capital from abroad. This inflow of capital, in turn, will finance a large and growing trade deficit for Mexico. Mexico will import capital goods from the U.S., which will create new jobs in Mexico. The resulting demand for U.S. investment goods (capital equipment, computers, etc.) will create new jobs in the United States. This is a textbook description of the presumed benefits of free trade. But like the CGE models they

criticize, Hufbauer and Scott design their own model to force the conclusion that both nations *have* to benefit from reduced trade barriers, i.e., the more Mexico exports the more it has to import from the United States — in a way that its imports rise even faster than its exports. As in the CGE models, the core assumption is that both nations benefit from increasing U.S. investment in Mexico. Not surprisingly, the models then conclude that there are benefits for both nations!

There are a number of flaws in Hufbauer and Schott's argument. First, the authors assert that the U.S. can indefinitely maintain a continuous (and growing!) trade surplus with Mexico by selling the Mexicans huge amounts of productive capital equipment without having to import the manufactured consumer goods that the capital goods will produce. Given Mexico's explicit strategy of expanding exports in order to pay down its foreign debt, it is unrealistic to posit that Mexico will go on buying machinery and inputs, while only exporting a fraction of that amount in consumer goods.[9]

Second, the scenario further assumes that Mexico will not develop the capacity to make its own capital goods. This is contradicted by Mexico's progress up the production ladder to higher value-added electronics and automobile production over the last ten years.

Third, the authors repeat — albeit indirectly — the unrealistic assumption of the CGE models that the net increase in foreign investment in Mexico does not come at the expense of investment in the United States. In order to come up with a net job gain for both the U.S. and Mexico, they focus exclusively on the trade balance. Importing capital goods creates jobs in the Mexican economy, in their model, since it is the shortage of capital goods in Mexico that limits the potential for job creation. Jobs are generated in the U.S. economy, on the other hand, by the *export* of capital goods. The loss of productive investment is not factored into the U.S. side of the equation. Thus, the fundamental objection to the NAFTA treaty is once again, simply "assumed away."

There is also the possibility that a large part of the new investment in Mexico might come from nations other than the U.S. One recent study (Cohen and Tonelson, 1991) postulates the effect of increases in non-North American investments in Mexico that would produce goods for the U.S. market. The result is a loss of up to 900,000 jobs by 1999. In this case the job loss in the U.S. would not be a result of investment diversion, but of an increase in consumer goods imports to the U.S. The study gives some indication of how dependent the IIE results are on the assumption that Mexico will continue to import the bulk of its capital goods from the U.S.

Fourth, the IIE study assumes that the peso will continue to rise against the U.S. dollar. The appreciation of the peso since 1987, which has made U.S. goods sold in Mexico cheaper, has been a major reason for the improvement in the U.S. trade balance with Mexico. Given the higher rates of inflation in Mexico, the peso is now clearly overvalued. Its value is being maintained by capital flows into Mexico, two-thirds of which is "hot money" — short term investments with tenuous commitment to Mexico (Whalen, 1992, p A13). Should the speculative air leak out of the Mexican stock and bond markets, the peso will plummet and the currency advantage which is essential to the projections of U.S. job gains will vanish.

The use of simplifying assumptions is common, and legitimate, practice in the exercise of economic logic. When used carefully by people who understand their limitations, such models of the real world are useful in gaining insights into the interactions of the various forces involved. But the simplifying assumptions do not reflect the real world, and to that extent will give a distorted and misleading result when they are used to *forecast* the effect of changes on real people. Thus, the problem is not one of statistical accuracy. i.e., that the conclusion of a gain of 130,000 U.S. jobs is not precise. The problem is that using these models to predict the outcome of a North American Free Trade Agreement treaty locks one into a logical sequence that can only lead to one conclusion. It is like predicting clear weather for tomorrow with a statistical model whose program does not recognize the possibility of rain.

Investment Diversion

Proponents of NAFTA often claim that the purpose of the agreement is to permit U.S. companies to better serve the Mexican consumer market. This is disingenuous. Mexico's attraction for U.S. manufacturers has never been Mexico's small consumer economy. Mexico's Gross Domestic Product is less than 4 percent of U.S. GDP. Indeed, it is the absence of middle-class incomes in Mexico that is the big attraction — the labor force of more than 30 million people willing to work for a tiny fraction of U.S. wages (See **Table 1**). Contrary to the assertions of free trade proponents, wage differentials are not typically compensated for by productivity differentials between the two countries. Harley Shaiken of the University of California at San Diego found that though a Mexican Ford engine plant was 80 percent as efficient as a U.S. plant, workers were paid only 6 percent of U.S. wages.[10] Similar wage-productivity gaps have been found in other industries, such as

TABLE 1
Comparison of North American Wages,* 1990

United States	Canada	Mexico
$14.83	$15.94	$1.85

*Hourly compensation costs in U.S. dollars for production workers in manufacturing.

Source: U.S. Department of Labor, Bureau of Labor Statistics. "International Comparisons of Hourly Compensation Costs for Production Workers in Manufacturing, 1990." Report 803, May 1991.

telecommunications.[11] Blomstrom and Wolff (1989) have shown as well that the productivity levels in multinational firms operating in Mexico approach U.S. levels.

It is common sense that corporations seeking to maximize profits will tend to locate production where overall costs — including unit labor costs (wages per unit of output), corporate taxes, and the costs incurred in complying with environmental or workplace safety regulations — are lowest. Of course, firms base production decisions on many less easily quantifiable factors as well: worker skills and reliability, quality of physical infrastructure, communications networks, and political stability, among others. The likelihood of transplanting production depends also on the nature of the goods produced. Even so, the vast disparity between U.S. and Mexican wages and the inconsistent enforcement of labor standards and workplace regulations in Mexico will combine to provide a powerful pull for multinational corporations currently producing (or contemplating production) in the United States.

The fundamental economic purpose of NAFTA is to facilitate the shift in investment to Mexico. That this is at least in part a conscious strategy of the Bush administration can be seen from instances in which high U.S. government officials have encouraged U.S. producers to shift to Mexico in order to take advantage of low wages. Indeed, then U.S. Secretary of Commerce Mosbacher distributed materials at a meeting of business investors interested in Mexico encouraging them to move south of the border and forecast even more cheap labor in the future because of a prospective increase in the "gap between the U.S. minimum wage and the Mexican direct wage."[12]

NAFTA will induce *increased* investment flows to Mexico in several ways. First, it will improve access to the U.S. and Canadian markets for companies producing anywhere in the continent. Even though most of the tariffs between the United States and Mexico have been removed or reduced since Mexico joined GATT in 1986, many nontariff barriers remain. NAFTA will eliminate or reduce most of these, including the Multi-Fiber Arrangement, which limits U.S. imports of textiles and apparel.[13]

Second, in the past, multinational corporations have been reluctant to make the massive long-term investment in plants and equipment needed to take full advantage of cheaper costs in Mexico because of concern over the political climate. Specifically, they fear a return of popular hostility to foreign investment and the threat of nationalization. NAFTA would put the rights of foreign investors into an international treaty that future Mexican governments would find it difficult or impossible to change. The International Trade Commission report notes that, "By codifying liberal trade and investment policies in an international agreement, . . . a United States-Mexico FTA would increase the confidence of investors in Mexico's economy" (ITC, 1991, p. viii).

Third, NAFTA will encourage investment by removing or weakening Mexico's remaining investment regulations. In particular, Mexico's negotiators have made critical concessions late in the talks to permit foreign investment in the politically sensitive areas of oil and agriculture.

Fourth, NAFTA will bring Mexico's intellectual property laws up to first-world standards. American firms had complained that Mexico's past failure to protect patents and copyrights had deterred investment there, especially by pharmaceutical and computer software companies who feared "knock-offs" and piracy by Mexican firms. After fast-track legislation passed in the United States in the spring of 1991, Mexican lawmakers did in fact enact more stringent patent and copyright laws. NAFTA will go still further.

The pressure from the U.S. business community on Mexico to further strengthen its intellectual property laws highlights the hypocrisy underlying the debate over NAFTA. Congressman Ron Wyden (D.-Ore.) wrote to Kay Whitmore, of the Kodak Corporation and the Business Roundtable, a U.S. business organization that has lobbied in favor of the free trade agreement: "The contradiction I see that greatly concerns me is that, while the Roundtable believes that the United States should require Mexico to raise its standards on intellectual property and investment to our level, I have been told that it does not believe that Mexico and the United States should raise their standards on environmental and labor

safety to the higher level in either country. I do not understand the rationale for that distinction."

Unfortunately, the rationale is fairly simple: as it stands, the agreement's purpose is to facilitate the mobility of capital while deliberately preserving the relative immobility of labor. While aggressively imposing strict investment standards that will have the effect of preserving or even raising corporate profits, the negotiators have modestly shied away from encroaching on Mexico's sovereignty in the areas of environmental and labor standards.

The result of this agreement will be to throw U.S., Mexican, and Canadian workers into competition with each other to attract investment by offering the lowest wages and the least restrictive regulations. The threat of moving production abroad is already a weapon many businesses use to oppose wage demands, environmental restrictions, higher corporate taxes, or stricter health and safety regulations.

NAFTA proponents are fond of making the point that the dollars invested by the U.S. in Mexico will come back in the form of payments for more U.S. goods. This is not necessarily true. Mexico can use the dollars to pay back its international debts, to increase its currency reserves or to buy investment goods from other nations — tractors from Japan, machinery from Europe, etc. It can also send dollars back into the U.S. in the form of purchasing existing assets, which will provide little in the way of jobs.

Supporters may be correct that in the first few years a large portion of the dollars invested in Mexico will come back to the U.S. in the form of purchases for U.S. goods. But over time there is little doubt that the creation of substantial new productive capacity will allow goods and services created with the combination of cheap Mexican labor and up-to-date U.S. capital to come flooding back into the U.S. markets destroying U.S. jobs.

Real World Evidence

Some indication of the effect of liberating investment to seek low-wage advantages is evidenced by past experience, both Canada's with the Canada-U.S. Free Trade Agreement implemented in 1989, and that of the United States with the Mexican maquiladora sector. In the case of Canada, a relatively small wage differential (about 1.17 to 1 as of early 1991)[14] was sufficient to induce hundreds of firms — both American subsidiaries and Canadian companies — to relocate production from Canada to the United States. According to the *New York Times*,[15] 87 Canadian firms had moved to Buffalo, New York *alone* as of the summer of 1991. Lower wages, lower taxes, and cheaper real estate in the United

States, combined with "practically unrestricted access" to the Canadian market, apparently offered many firms an irresistible temptation to relocate or expand south of the border.

According to Statistics Canada, 461,000 manufacturing jobs were lost between June 1989 and October 1991 — almost a quarter of the manufacturing workforce.[16] The Mulroney Administration and other FTA proponents claim that the severe job loss can be attributed entirely to the over-valued Canadian dollar and the recession. While the recession and overall "restructuring" of the Canadian economy certainly contributed to the problem, the magnitude and nature of the Canadian job loss undermines the credibility of this line of argument. During the same period, the United States lost only about 6 percent of its manufacturing jobs, although its industrial sectors were also restructuring in a recession. In Ontario, the proportion of jobs lost due to plant closing (as opposed to temporary layoffs) was more than twice as high from 1990 to 1992 as it was during the 1982 recession.[17]

The exact number of Canadian jobs lost to the FTA is in dispute, but that a large number of jobs are involved is certain. As is the fact that the confident predictions of job gains for Canadian workers — argued with the same logic that NAFTA proponents are now using — have not been borne out.[18]

The Canada-U.S. Free Trade Agreement has also had a depressing effect on other aspects of Canada's economic life. Canada's well-developed social insurance, safety net, and public investment policies are already being eroded by its trade agreement with the United States. Professor Ricardo Grinspun of York University in Toronto writes, "A key problem of [the Canada-U.S. Free Trade Agreement] is that it restricts the ability to carry out policies that make significant contributions to productivity gains and other legitimate policy goals. These policies are in areas like education, regional development, job training, research and development, technology, social programs and health. The United States challenges many of these Canadian policies as 'unfair' trade practices" (Grinspun, 1991, p. 3).

U.S. experience with Mexico's maquiladora export zone also reinforces the idea that investment decisions are quite sensitive to changes in trade policy. The rapid expansion of maquiladora production — in which goods are assembled in Mexico from imported parts and reexported to the United States, paying tariff only on the value added in Mexico — has shifted hundreds of thousands of jobs from the United States to Mexico.[19] Currently, about

500,000 Mexican workers are employed in maquiladoras, at an average wage approximately half that prevailing in the rest of Mexico's manufacturing sector.[20]

A popular misconception about maquiladoras is that they produce only low-skill, labor-intensive goods. While this may have been true when the maquiladora zone was set up 20 years ago and the main activity was sewing garments, it is no longer the case. Today, apparel accounts for fewer than 10 percent of maquiladora workers; more than 40 percent work in electronics and 20 percent in transportation equipment (Schoepfle, 1990). One-third of non-oil U.S. imports from Mexico come from the maquiladora sector. Auto and electronics companies in particular have been increasingly willing to put sophisticated, state-of-the-art plants in Mexico, as skills, infrastructure, and corporate experience there have increased. In the future, we should expect Mexico's productive capabilities to continue to evolve and grow as they have done in the past.

NAFTA itself will also worsen the impact of the maquiladora program on the U.S. market. On the one hand, Mexico's strict rules governing foreign investment will be further loosened by NAFTA, expanding the opportunities for U.S. producers to take advantage of cheap labor more widely throughout Mexico.

On the other hand, some of the small compensations the U.S. economy currently receives from the maquiladora system will disappear with the adoption of NAFTA. The system now requires plants exporting to the U.S. to purchase U.S. components.[21] After a transitional period under NAFTA, the maquiladoras will no longer be required to buy components in the United States in order to obtain duty-free access to the U.S. market.

The real advantage of producing in the maquiladora sector does not lie in avoiding tariffs, however, but rather in taking advantage of ultra-cheap wages and lax environmental and labor standards. Wages in the maquiladora sector are approximately one-tenth to one-fourteenth of U.S. manufacturing wages, and the Mexican government has lacked both the resources and the will to enforce even basic worker-safety provisions or environmental regulations.

Although the Mexican government has proclaimed its commitment to strengthening environmental standards and worker protection, it seems unlikely that under current political circumstances changes will go deep enough to close the yawning chasm between the two countries in these arenas. Indeed, whatever progress has been made so far — such as the highly publicized closing of the port of Veracruz — is a result of personal pressure from Salinas. He is engaged in a transparent campaign to win ratification for the trade

agreement from the U.S. Congress. There is no serious, independent political force in Mexico to maintain such pressure once the agreement is ratified. In fact, Mexican political scientist Adolfo Aguilar Zinser (in Cameron and Grinspun, 1992) has argued that NAFTA will exacerbate Mexico's tendency toward centralized political and economic power. Thus, it is likely that the factors attracting U.S. investment to the maquiladoras during the last ten or twenty years will continue to play a role — and perhaps an increasingly important one — in the post-NAFTA business climate.

Measuring the Effect of Investment Diversion on Job Loss

As discussed earlier, most of the conventional studies that have attempted to quantify NAFTA's impact on the U.S. economy have either ignored the shift of investment from the United States to Mexico or have examined only the Mexican side of the equation. Yet, the extent to which investment in Mexico replaces investment in U.S. plants clearly will determine NAFTA's overall impact on U.S. jobs.

Two recent studies have estimated the impact on the domestic labor market by a shift of investment from the United States to Mexico. Like the studies described above, they are models with their own sets of simplifying assumptions. But their results, employing different methodologies, provide estimates that expand the limits of the debate.

An Economic Policy Institute briefing paper (Faux and Spriggs, 1991) reported the dramatic results of modifying one standard computable general equilibrium model of U.S.-Mexico relations to allow for a modest shift of capital between the United States and Mexico. The analysis, by economists Raul Hinojosa-Ojeda and Robert McCleery, involved reducing the risk premium for U.S. firms investing in Mexico. Free trade was modelled as an elimination of tariffs between the two countries over 10 years beginning in 1992. The differential in returns to capital between the U.S. and Mexico was allowed to fall by two percent the first year of the agreement, and one percent each additional year until the year 2000, for a ten percent overall decline in the risk premium.

This scenario results in a movement of $44 billion in capital from the United States to Mexico over the decade. As a consequence, during the first ten years of the agreement 550,000 fewer high-wage jobs are created in the United States than would have been the case in the absence of the agreement, and the U.S. Gross Domestic Product falls by $36 billion relative to the no-FTA scenario. Because the model assumes full employment, these workers do get jobs, but they take a 50 percent wage cut. Some of this employment-shifting

effect is due to the repercussions of reduced immigration from Mexico, since the model finds that real wages in Mexico rise as a result of the increased investment.

Economists Timothy Koechlin, Mehrene Larudee, Sam Bowles, and Gerald Epstein (1992) have also developed an estimate of job displacement. They find that NAFTA will result in the loss of 290,000 to 490,000 U.S. jobs over the next 10 years, as U.S. and foreign investors build new capacity in Mexico, rather than in the United States, attracted by improved access to the U.S. market and a more stable investment climate in Mexico. They base their estimate on historical examples of the increases in U.S. foreign direct investment that took place when Ireland and Spain joined the European Community (in 1974 and 1986, respectively). "There are parallels to be drawn between Ireland's joining the European Economic Community and Mexico joining the North American free trade area," says Koechlin, et al. "Both are relatively low wage areas and both joined markets many times their size. U.S. investment in Ireland increased almost fourfold as a result of its EEC membership. There is good reason to think that U.S. investment in Mexico will also take off as a result of its joining the much larger U.S. market."

Both of the above models assume that increased investment in Mexico directly reduces investment in the United States by an equivalent amount. Some unknown amount of this new investment in Mexico may otherwise have gone to Asia, not to the United States. But there is no strong evidence to suppose that this would represent the bulk of capital flows. Mexican wages are even lower than wages in the Asian newly industrializing countries (NICs), yet productivity is comparable in many sectors. Moreover, some *foreign* investors who — in the absence of a free trade agreement — would have invested in the U.S. in order to sell in the U.S. market may now choose to invest in Mexico. The other NICs cannot offer equivalent access to the big U.S. and Canadian markets that Mexico can offer *now*. This further reduces investment in the United States beyond what these models have accounted for.

Wages and Living Standards

The distributional consequences of NAFTA — that is, its impact on wages and income distribution — may be at least as important as aggregate job loss. Economist Edward Leamer (1992) has argued that NAFTA is likely to further polarize the U.S. earnings distribution. Leamer examines international trade and wage trends over the last two decades. He finds, that as trade and investment barriers have come down, it has become

easier for capital to locate in low-wage countries where it earns a higher rate of return. This has increased the supply of labor-intensive goods, so that their price has fallen relatively. This, writes Leamer, "has put downward pressure on the wages of low-skilled workers in the developed countries" (Leamer, 1992, p. 11). He warns that NAFTA will significantly limit the ability of the U.S. to restrict its imports of labor-intensive goods in the future, and that "low-skilled" workers in the U.S. will suffer as a consequence.

"Indeed," he writes, "if the reason for the expansion of international commerce is increased access to low-wage unskilled foreign labor it is virtually certain that our low-skilled workers will have their earnings reduced. Earning reductions on the order of $1000 per year . . . seem very plausible" (Leamer, 1992, pp. 45-46). Leamer estimates that "professional" or high-skilled workers and owners of capital will experience increases in income as a result of NAFTA. Is this a tradeoff that the United States is ready to make? Before making any decisions, it is important to look more closely at Leamer's definition of "low-skilled" workers. It turns out that this category includes all workers who are not professional, technical, or managerial: this comes to over 70 percent of the workforce! It is interesting to note that this exactly parallels the predictions of the initial ITC report (USITC, 1991, p. viii), which also found that "real income for unskilled workers is likely to decline slightly." When pushed to define "unskilled" workers, the ITC reluctantly admitted that they included all workers with a high-school education or less — this also comes to about 70 percent of the workforce.[22]

It is important to view this potential erosion of wages in the context of the other changes that have been occurring in the U.S. economy in the last decade or two. Real wages have been stagnant or falling for almost two decades. Workers without a college degree have seen the largest declines, and young workers have been especially hard hit. A recent EPI Briefing Paper (Mishel and Bernstein, 1992, p. 2) found that young male high school graduates earned 26 percent less in 1991 (in real terms) than equivalent workers did in 1979. The most startling finding in the paper, however, was that, since 1987, the real wages of college graduates have also begun to decline. This suggests that the blithe triage that NAFTA proponents envisage — of gains for skilled workers and losses for unskilled workers — may be overly optimistic. If we let our so-called low-skilled workers go down the ladder, we may find ourselves joining them a few years from now.

NAFTA as a Low-Wage Strategy

Perhaps the greatest danger to the U.S. economy from adopting NAFTA is that it will encourage American firms to seek a low-wage solution to the challenge of global competition. The Commission on the Skills of the American Workforce, led by Ira Magaziner, William Brock, and Ray Marshall, recently concluded that we face an historic strategic choice in how we respond to the global marketplace. One strategy — the "high-skills, high-wage" path — competes by producing innovative high-quality goods efficiently so that they can be sold at high enough margins in the global marketplace to pay high wages and maintain U.S. living standards. This path requires the maintenance of correspondingly high levels of private and public investment to continually upgrade the quality of our capital and labor.

The alternative "low-wage" path means competing on the basis of cutting labor costs. This is the strategy of the agreement negotiated by the Bush, Salinas, and Mulroney Administrations. One of the conceptual problems in the North American Free Trade Agreement debate has been the assumption on the part of NAFTA proponents that the *benefits* of the agreement will be permanent, while the costs will occur only once. This betrays a misunderstanding both of NAFTA itself and of its place in the long-term strategy of the United States. Whether we choose to see NAFTA as an event or a process will also influence the social and labor adjustment policies we think will be needed to accompany it.

President Bush has already indicated clearly that the free trade agreement with Mexico is only the first step in a long-term process toward developing similar agreements with other Latin American countries. Indeed, such discussions are already taking place under the rubric of the Enterprise for the Americas Initiative, which would promote trade and investment, eventually culminating in "a vast free trade and investment zone encompassing the entire Western Hemisphere by the year 2000" (Diebel, 1992). At a conference sponsored by the Americas Society and the Council of the Americas in Washington, D.C., in April, chairman David Rockefeller laid out the political strategy for such an initiative: "It's you, the business community of the Americas that is {sic}going to have to provide the leadership, both the practical and the moral leadership, to carry through this process of reform. . . . It's you who will have to stay the course when the politicians, under an increasing barrage of complaints and inducements from various pressure groups, begin to waffle" (Diebel, 1992). For "various pressure groups," read: 70 percent of the U.S. workforce.

Thus, NAFTA represents a major long-term incentive for U.S. producers to respond to global market competition by following the low-wage option rather than the more difficult path of producing quality products more efficiently.

Clearly, it is the intention of the Bush-Salinas-Mulroney strategy that NAFTA will be a dynamic, ongoing process, not a one-time event. Mexico has already climbed several rungs up the production ladder since the start of the maquiladora program. If our economies are going to be tightly linked for the indefinite future, it makes more sense to consider what their industry, infrastructure, and workforce will look like in ten years, rather than to dismiss Mexico's productive potential on the basis of its current abilities.

Mexico's labor force is currently growing at a rate of one million per year, while only about 300,000 to 400,000 jobs per year are being created in the formal economy.[23] Even at an extremely high rate of future growth of 5 or 6 percent, the Mexican economy will not be able to generate enough jobs to reduce unemployment significantly from its current rate of about 20 percent.

Exporting manufactured goods to the United States in and of itself is unlikely to close the gap between available jobs and needed jobs in Mexico. The entire maquiladora sector accounts for only 500,000 jobs — not enough to absorb Mexico's surplus labor for a single year. For the foreseeable future, the U.S. consumer sector will be too weak to lift the U.S. economy onto a strong recovery path, let alone act as a consumption engine for both the U.S. and Mexico.

Given these prospects for continued high unemployment and Mexico's lack of meaningful democratic institutions and strong and independent labor unions, we cannot assume that wages will necessarily rise to reflect productivity gains there. Protections against environmental exploitation and labor abuse in America are not achieved simply by the laws enacted by government, but by the strength of independent institutions, such as environmental organizations, civil rights groups, and labor unions. Their ability to monitor, to expose, to sue in court and to defeat candidates who are indifferent to their concerns is the rock upon which such protections are founded. Mexico's one-party system, with its interconnections between business, labor, and political institutions, does not yet provide the culture to nurture the necessary independent advocacy, membership, and pressure groups.[24] Indeed, after taking power in a tainted election in 1988, Salinas has strengthened the one-party monopoly power of the Institutional Revolutionary Party (known by its Spanish acronym, PRI). As Business Week commented in a July 1992

editorial: "Now, elections in Mexico are increasingly irrelevant. The only opposition candidates who win are de facto allies of Salinas, including the victor in the Chihuahua state elections, Francisco Barrio of the conservative National Action Party (PAN)."[25] Given this fundamental lack of democracy, it is irresponsible for U.S. leaders to sign an agreement that relies on domestic pressures within Mexico to enforce labor, health and environmental standards.

The risks of job and income loss from NAFTA cannot be avoided by the Administration's effort to "tack on" promises to increase funding for job training or to obtain promises from Mexico that present and future governments will be more sensitive to human rights and environmental regulation. The political and economic dangers inherent in such a strategy are enormous, and require a public debate that goes beyond the narrow, ideological wrangling and political horsetrading now going on to garner the votes necessary to pass NAFTA.

Yet far from rising to meet the challenge of global competition, federal spending on education and training has fallen in the last 15 years as a percentage of GNP. In 1976, the federal government spent 0.8 percent of GNP on education and training; by 1990, this figure was only 0.5 percent. This decrease in spending has real consequences for workers whose skills need upgrading: the primary federally supported training program, the Jobs Training and Partnership Act, currently serves only 6 percent of a narrowly defined eligible population (Faux and Schafer, 1991). During a period when the U.S. trade deficit increased nearly fivefold (from the late 1970s to the late 1980s), the Trade Adjustment Assistance Program *reduced* the number of applicants it served from 199,000 to 37,000. It now serves only one out of four eligible workers (Friedman, 1991).

Despite the Bush Administration's assertions that they will somehow take care of workers who lose their jobs because of NAFTA, there is little cause for optimism. In its proposed budget for fiscal year 1993, the Administration *reduced* overall funding for worker training programs by 6.6 percent (in nominal terms). It eliminated the training component of the Trade Adjustment Assistance program entirely and cut TAA benefits in half.[26] There has been no serious planning effort on the part of the Administration in the last year to estimate potential dislocation or to develop adequate transitional programs. While no one expects adjustment assistance to be part of the trilateral negotiations, the adjustment assistance package should have the same weight of formality and commitment as the agreement itself. Otherwise, political pressure for reducing the deficit and holding the line

on taxes will squeeze out funding for these programs. The recent spectacle of both Democrats and Republicans climbing onto the bandwagon of the balanced-budget amendment to the Constitution provides a foreshadowing of bitter budget battles to come.

Thus, one absolute requirement for a trade agreement should be a credible and comprehensive strategy for worker training and job creation — *and* a commitment to fully fund such a strategy. A free trade agreement should not be implemented until such a system is solidly in place.

The onus is on those who advocate a North American free trade agreement to develop a plan for providing American workers with a ladder of upward mobility. They need to convince the rest of us why the pattern we have seen so often and so clearly in the past — of workers displaced by trade bearing most of the burden of adjustment — will not repeat itself in the future. And in this case, there is reason to believe that more than those individuals who actually lose their jobs as a result of trade and investment will suffer: every worker whose wage is bid down by the threat of corporate mobility, every community whose environmental standards are weakened, and everyone whose community is disrupted by the large-scale loss of jobs will pay part of the price.

A Social Dimension in Trade

One way in which several of the European governments have attempted to guide their economies onto a high-wage, high-value-added growth path has been to shut off the low-wage option — by setting a relatively high minimum wage, regulating plant closing, and legislating livable welfare, pension, and unemployment compensation benefits. This has forced companies to seek productivity improvements via investments in modern equipment and new technology and more interactive labor-management relations. NAFTA takes us in exactly the opposite direction — opening the door wide for U.S. corporations to seek the low-wage solution and obviating the need for investment in the labor force of either Mexico or the United States. While this may add to corporate profits in the short run, in the long run it will undermine the productivity and thus the competitiveness of the entire continent.

The Europeans have attempted to build a Social Dimension into their process of economic integration. The Social Dimension has two aspects: 1) the Social Charter, which establishes the principle that trade should not be based on "social dumping," where poorer countries follow low-wage, low-regulation strategies in order to increase exports; and 2) the

Structural Funds, which help redistribute resources within the European Community to poorer countries, regions, and disadvantaged groups. The Structural Funds in turn are made up of two components: the regional fund, which provides financing to help narrow the gap between the levels of infrastructure in the poorer and the more developed EC countries[27]; and the social fund, which is used to address problems of long-term or youth unemployment at the level of the individual firm or industry. Employee and employer organizations can apply for these funds when they need financing for a specific project.

German Trade Union Confederation Vice President warned that, "In the absence of 'social rules of the game,' the battle of [European] Community-wide competition would be fought on the backs of the workers." This principle has not yet been accepted in the United States.

The U.S. ideological commitment to free trade has translated into a presumption that *free trade alone* is sufficient to raise incomes and employment levels. Proponents argue that the best way to end child labor and environmental degradation in Mexico is to pass a free trade agreement. They reason that the higher incomes associated with freer trade will automatically allow stricter regulation and enforcement of environmental and labor standards. But this confuses correlation with causality. Higher incomes may be a necessary condition, but they are not a sufficient condition for keeping kids out of factories and caring about clean air. Democracy and citizen input into the government decision-making process are also crucial, and at the moment, these are lacking in Mexico.

The European attitude toward free trade, in contrast, is pragmatic. If ending child labor is the goal, the Europeans are not content with enacting a broad free trade agreement and then sitting back for a few decades waiting for it to work. They have written specific enforceable standards into EC-wide law in the areas of greatest concern.

Existing European law in the areas of health-care, child development, worker training, and adjustment assistance is much more extensive than comparable U.S. laws — even before the European Social Charter is fully implemented. In the area of unemployment insurance, for example, France provides benefits equal to 50 percent of lost earnings for up to two years. Germany is even more generous, paying 66 percent of normal wages for up to 18 months, and 58 percent for an unlimited time after that. In contrast, U.S. unemployment benefits average only one-third of lost pay, and in all but three states, benefits are exhausted after six months. U.S. government expenditures on worker retraining also lag behind those in France, Germany, and the United Kingdom. The U.S. spends only

$1800 per participant on training, while Germany spends four times that amount, on average.[28] This higher European "baseline" makes their task — of adapting the economy to the needs of increased economic integration — easier than ours.

To meet the challenge of increasing global economic integration — of which NAFTA is only one element — the United States must embark on a permanent and continuous upgrading of its labor force in conjunction with trade and industrial policies that provide support for high-wage job creation. Only if such policies become conscious national goals is there any realistic chance to build the ladder that will make the difference between displaced U.S. workers sliding downwards toward higher unemployment and lower-paying jobs or climbing up to the next rung.

Without a skilled, well-paid, and adaptable labor force, the United States will find it virtually impossible to compete in global markets for anything but standardized, mass-produced goods that generate lower and lower wages. The need to invest in the U.S. labor force goes way beyond aid to workers displaced by trade. The United States should be looking to the future, and toward a whole new labor-market process that starts in childhood and extends beyond retirement. To this end, we should fully fund child health and nutrition programs, including WIC (Women, Infants, and Children Supplemental Food Program); restore funding to Head Start, whose effectiveness has been shown time and again; and fund long-term *paid* training programs for displaced workers. (If these training programs do not include income support, then only workers with private income sources can afford to take advantage of them.) Any trade adjustment assistance should also include a continuation of medical benefits for displaced workers, as well as a bridge benefit for workers within four years of retirement age.

One example of the broader vision necessary for the United States to absorb the shock of the free trade agreement can be found in the proposals outlined in *America's Choice: High Skills or Low Wages*, the 1990 report of the Commission on the Skills of the American Workforce. The commission recommends giving all employers "incentives and assistance to invest in the further education and training of their workers and to pursue high productivity forms of work organization" (p. 7). In particular, employers would be required to spend at least one percent of their payroll on employee education and training programs, or to contribute the same amount to a state-administered general training fund. Public grants would be available to assist firms in moving to higher performance work organizations. The states would also be responsible, with federal assistance, for assuring

that all students met a higher national standard of educational excellence by age 16. Local Employment and Training Boards would create and fund alternative learning environments for students who were unable to meet that higher standard in regular schools. In order to help prepare non-college bound students for the workplace, the Commission recommends creating a system of Technical and Professional Certificates and associates' degrees to be earned through completion of two- or four-year courses of combined study and work, modelled on the formal apprenticeship programs in other countries.

Government, business, professional commissions, and other researchers have attempted to estimate how much money would be necessary in order to fully fund human resource investments, including education and training and some child health and nutrition programs. Their estimates range from $29 billion to $58 billion annually. The *total* investment gap — including physical capital and research and development in addition to human resources — ranges from $63 billion to $126 billion. Robert Heilbroner (1991), professor emeritus of economics at the New School for Social Research, has argued that the United States needs to quadruple its expenditures on public investment just to catch up with our principle competitors, Germany and Japan.

And finally, the government needs to take some responsibility for targeted job creation. Training and educating workers is essential, but it does not guarantee that the jobs will be there when needed. Sheldon Friedman of the AFL-CIO advocates using economic conversion proposals, including planning grants and subsidized loans, to bolster employment in affected regions or localities. The government could also create jobs related to commercial technologies that meet national needs, such as mass transit/high-speed rail or high-definition television, for example.[29]

The principle underlying the EC's "activist labor-market policy" is that good trade adjustment policies are neither optional, nor do they constitute "charity." By their nature, freer trade and investment flows cause disruption and dislocation, as economies adjust to new sources of production and attempt to find their niches. By easing the process of change, and by protecting workers from the worst effects of this disruption, adjustment policies *make change possible* (Collins, 1983, p. 3).

Over the long term, failure to invest in its workforce will disadvantage North American producers when competing with the Europeans and the Japanese in the production of customized, high-quality goods and services. At the same time, North American producers will be equally disadvantaged in competing with low-wage Asian producers

in markets for standardized, price-competitive goods. The United States cannot win an international contest based on cutting wages — nor is it in its long-term interest to be a victor in such a contest.

Mexico's Ladder

Will a laissez-faire NAFTA help Mexico continue to grow and develop its economy? For Mexico, even more than for the United States and Canada, a free trade agreement can be one element of a development strategy, but it is far from sufficient. The most important single action the United States could take to spur development in Mexico would be to relieve it of its crushing debt burden. But any hopes that NAFTA would achieve this were dashed when the negotiators announced that debt relief for Mexico was "off the table" from the beginning of the talks.

Short of debt relief, strict standards written into NAFTA itself can help assure that the agreement does not simply exploit Mexico's relative poverty. A coalition of labor, environmental, and development groups (the Mobilization on Development, Trade, Labor and the Environment—MODTLE) has formulated a set of criteria that provide a framework for a more enlightened approach to this critical question. Among others, the MODTLE criteria include:

—Fair labor practices enforcement mechanism. The agreement must incorporate a mechanism whereby trade unions or individuals can challenge any infraction of labor rights or workplace standards in export-producing industries, bringing such infractions to reasonably swift adjudication before an international body.

—Enforcement of the rights of free association and collective bargaining.

—Harmonization *up* of workplace health and safety standards. Regional standards must in no case be lower than those in any of the three countries.

—Social infrastructure investment. Companies that invest in each of the countries could contribute to a fund to support social infrastructure in the communities in which they operate, including medical care, community development, and education.

—Environmental assessment of NAFTA's impact prior to and during its planning. This procedure should be carried out by each of the three governments and should be open to citizen input at every stage.

—Preservation of strong environmental standards. Nothing in NAFTA should require or encourage state, local, or national governments to loosen restrictive environmental or consumer protection laws. The recent GATT ruling in Mexico's favor on the issue of dolphin-killing tuna fishing sets an ominous precedent for trade agreements to undermine progressive national legislation when that legislation restricts trade.

—Prevention of environmental dumping. In order to prevent corporations from locating production where environmental regulations are weakest, a countervailing duty should be imposed on industries that do not meet pollution control standards in the countries to which they are exporting. The duty would be equivalent to the corporation's savings from non-compliance, thus eliminating the economic advantage of such behavior.

—Commitment to internationally recognized human rights, with strengthened redress procedures. NAFTA signatories should agree to adhere to the American Declaration of the Rights of Man, the Charter of the Organization of American States, and the American Convention on Human Rights, if they have not already done so. Parties should recognize the jurisdiction of the Inter-American Court of Human Rights, in cases where national judicial procedures are questioned.

Electoral, political, social, and cultural rights should also be acknowledged as crucial to the success of a free trade agreement. Even if not included in the body of NAFTA, these rights could be ratified in a parallel tri-national agreement.

It also seems important to explore the possibility of raising and enforcing the minimum wage in Mexico, perhaps as a condition of signing the agreement. The growing divergence in Mexico between productivity growth and real wage increases signals a market failure of some sort in that country, perhaps reflecting the political imbalance of power there or the downward pressure on wages from the large informal sector and the large

numbers of under-employed workers. As Walter Russell Mead (1991, p. 37) has argued, "low wages in developing countries contribute to a weakness of global demand and . . . this weakness in turn undermines political support for the multilateral free trade system." A higher enforced minimum wage in Mexico — that better reflected productivity levels — - would serve two purposes: it would give Mexican workers more purchasing power, so that Mexican growth would not have to rely solely on exports; and it would relieve some of the pressure on U.S. and Canadian workers to accept deep wage cuts.

NAFTA essentially amounts to a contract between the governments of the United States, Canada, and Mexico. But until democracy in Mexico is strong enough and functional enough to give its citizens an effective voice in this process, we cannot be sure exactly who we are signing this contract with, or whose interests it will serve. The EC waited until Spain and Portugal had established civilian democracies before allowing them to join the Common Market. We should give Mexico the same opportunity before rushing to link our economy — and by extension — our political system with theirs.

The Bottom Line

If the North American Free Trade Agreement cheerleaders are right, and incomes and employment levels rise in all three countries as a result of the agreement, then the stringent standards and adjustment programs we advocate here will be at worst an inconvenience. They also will not impede positive change. For example, if income growth in Mexico actually does lead firms to act more environmentally responsible, then they won't mind having to abide by stricter standards. And if few workers are displaced by the free trade agreement, then the training and adjustment programs won't cost very much to run.

But if the cheerleaders are wrong, then their policy prescription — to barrel ahead with an "unencumbered" agreement and desultory adjustment assistance — could have disastrous short-term consequences for hundreds of thousands of U.S. working people and negative long-term effects on the living standards and competitiveness of the entire continent.

Endnotes

1. Displaced Workers, 1981-85. BLS Bulletin #2289, September 1987, p. 3. The sample includes only those workers who had worked at their jobs for three or more years before being laid off due to plant closing or moves, slack work, or the abolishment of their positions or shifts.

2. The job loss figure is from Cohen and Tonelson (1991), and the job gain figure is from Hufbauer and Schott (1992).

3. The only exception (the Roland-Holst et al. model) fixes the wage rate and allows employment to fluctuate, also an unrealistic characterization of the labor market. The Bachrach-Mizrahi model actually assumes full employment for the United States, but allows unemployment in Mexico. This has the effect of increasing the gains from trade for Mexico as unemployed people are put to work, while unemployment in the United States is blithely assumed to be zero. Stanford (1992, p. 28) notes this questionable selectivity, writing that "full employment is assumed for cases when unemployment might increase as a result of free trade, but not when it might decrease."

4. See especially the Bachrach-Mizrahi study and the Brown-Deardorff-Stern study, both of which make the assumption that foreign investment increases in Mexico without andy corresponding reduction in domestic U.S. investment (USITC, 1992b).

5. Stanford (1992, p. 6). Stanford's testimony provides detailed and insightful critique of the CGE models reviewed by the ITC.

6. The models show Mexico and Canada experiencing larger gains from trade liberalization (at the high end of the range) than the United States because their economies are more dependent on trade with the United States than vice-versa.

7. See Grinspun (1992) for a critique of the CGE models used to predict the impact of the Canada-U.S. FTA. Grinspun compares the models' predictions to the actual performance of the Canadian economy in the two and a half years following the implementation of the agreement. He finds no correlation whatsoever between the predictions and the actual outcome.

8. This process is apparent at any public forum in which modelers meet to discuss their models. At the ITC symposium (February 24 and 25, 1992) where the models were presented, the authors frankly discussed their disappointment with the initial results of the CGE models, which uniformly showed very small gains from trade. Various features were then piled on, one at a time, until the gains from trade were more in line with the prior expectations of the authors.

9. Hufbauer and Schott take as fixed the proportion of Mexico's trade with the United States, which is currently about 75 percent. They also take as fixed the percent of Mexico's imports from the United States that are made up of capital goods (currently about 85 percent).

10. As cited in Mead (1991, pp. 17-18).

11. See Moody and McGinn (1991, p. 12).

12. *A Partnership for Growth: Investing and Manufacturing in Mexico*, briefing book distributed by Commerce Dept. to U.S. business executives in Los Angeles, 10/26/90; see also Faux and Rothstein (1991, p. 13).

13. Note that even though the import quotas facing Mexico under the MFA are quite flexible, the formal lifting of quotas under NAFTA may attract additional investment by offering essentially unbounded access to the U.S. market.

14. "Free Trade Accord is Enticing Canadian Companies to U.S.," New York Times, August 9, 1991, p. 1.

15. New York Times, August 9, 1991.

16. See Campbell (1992) for a more thorough discussion of this point.

17. From a presentation by John O'Grady at a conference held at the Institute for International Economics in Washington, D.C., June 22, 1992.

18. Note that the CGE models do not include any monetary variables, and so cannot incorporate the results of changes in currency values.

19. Steve Beckman testimony before the Trade Policy Staff, 9/4/91.

20. The wage figure refers to 1989, while the number of maquiladora workers is for 1991. The source for the maquiladora wage is the Bureau of Labor Statistics, Office of Productivity and Technology, "International Comparisons of Hourly Compensation Costs for Production Workers — Mexico" (April 1990). There are some indications that the maquiladora wage has risen relative to the average manufacturing wage since 1989, but no official estimates are available at this time. Note also that the maquiladora wage is higher than that prevailing in Mexico's informal sector, where many maquiladora workers are drawn from.

21. U.S. tariff code item 807, now known as item 9802, grants items assembled abroad from U.S. components easier access to the U.S. market.

22. After a mild political brouhaha over this prediction, the ITC released a revised estimate (with an altered supply elasticity) that found that all workers did in fact benefit from NAFTA.

23. Mexico: Trade and Industry Report, Office of Trade and Initiatives, Trade Analysis Division, November 1990, p. 9.

24. Faux and Rothstein, "Fast Track-Fast Shuffle."

25. "Salinas' Grip on Mexico is so Strong He even Wins When He Loses," Business Week, July 27, 1992, p. 45.

26. While the Administration has stated that it would like to merge TAA with the less costly (and non-entitlement) Economic Dislocation and Worker Adjustment Assistance program, the cuts in TAA exceed the increases in EDWAA funding.

27. New York Times, October 7, 1991.

28. "European Worker Benefits," AFL-CIO Reviews the Issues, Report No. 55, September 1991.

29. See, for example, Cohen and Donow (1989) and Sanderson (1989).

References

Blomstrom, Magnus and Edward N. Wolff. *Multinational Corporations and Productivity Convergence in Mexico.* NBER Working Paper No. 3141. Cambridge: National Bureau of Economic Research, 1989.

Cameron, Maxwell and Ricardo Grinspun, eds. *Critical Perspectives on North American Integration* New York: St. Martin's Press, forthcoming, 1993.

Campbell, Bruce. "Goin' South — Two Years Under Free Trade," *Canadian Dimension,* January-February 1991.

Cohen, Robert B. and Kenneth Donow. *Telecommunications Policy, High Definition Television, and U.S. Competitiveness.* Washington, D.C.: Economic Policy Institute, 1989.

Cohen, Robert and Alan Tonelson. *Doing It Right: A Winning Strategy for U.S.-Mexico Trade.* Washington, D.C.: Economic Strategy Institute, 1991.

Collins, Doreen. *The Operation of the European Social Fund.* London: Croom Helm, 1983.

Commission on the Skills of the American Workforce. *America's Choice: High Skills or Low Wages.* Rochester: National Center on Education and the Economy, 1990.

Cypher, James. *State and Capital in Mexico.* Boulder: Westview Press, 1990.

Dallas draft of the North American Free Trade Agreement. Mimeo. February 21, 1992.

Diebel, Linda. "Will U.S. Dominate Hemispheric Trade by the Year 2000?" *Toronto Star,* April 25, 1992.

Dornbusch, Rudiger. "U.S.-Mexico Free Trade: Good Jobs at Good Wages," Testimony before the Subcommittee on Labor-Management Relations and Employment Opportunities, Committee on Education and Labor, U.S. House of Representatives, April 30, 1991.

Faux, Jeff and Richard Rothstein. *Fast Track-Fast Shuffle: The Economic Consequences of the Administration's Proposed Trade Agreement with Mexico.* Washington, D.C.: Economic Policy Institute, 1991.

Faux, Jeff and Todd Schafer, "Increasing Public Investment: New Budget Priorities for Economic Growth in the Post-Cold War World." Washington, D.C.: Economic Policy Institute, 1991.

Faux, Jeff and William Spriggs. *U.S. Jobs and the Mexico Trade Proposal.* Washington, D.C.: Economic Policy Institute, 1991.

Friedman, Sheldon. "Trade Adjustment Assistance: Time for Action, Not False Promises," *AFL-CIO Reviews the Issues,* Report No. 53, September 1991.

Grinspun, Ricardo. "North American Free Trade Area: A Critical Perspective." Paper presented at Facing North/Facing South, conference at the University of Calgary, Canada: May 1991.

Grinspun, Ricardo. "Are Economic Models Reliable Policy Tools? Forecasting Canadian Gains from Free Trade." Forthcoming.

Heilbroner, Robert. "Lifting the Silent Depression." *New York Review of Books*, October 24, 1991.

Hufbauer, Gary Clyde and Jeffrey J. Schott. *North American Free Trade: Issues and Recommendations*. Washington, D.C.: Institute for International Economics, 1992.

Leamer, Edward E. *Wage Effects of a U.S.-Mexican Free Trade Agreement*. NBER Working Paper No. 3991. Cambridge, Mass.: National Bureau of Economic Research, February 1992.

Koechlin, Timothy, Mehrene Larudee, Samuel Bowles, and Gerald Epstein. "Effect of the North American Free Trade Agreement on Investment, Employment and Wages in Mexico and the U.S." Mimeo, February 1992.

Mead, Walter Russell. *The Low-Wage Challenge to Global Growth: The Labor Cost-Productivity Imbalance in Newly Industrialized Countries*. Washington, D.C.: Economic Policy Institute, 1991.

Moffett, Matt. "Stock Prices Drop Sharply in Mexico and U.S.: Mexican Market Sees Foreigners Streaming Out," *Wall Street Journal*, June 18, 1992, p. C1.

Moody, Kim and Mary McGinn. "From the Yukon to the Yucatan." *Dollars & Sense*, November 1991.

Papageorgiou, Demetris, Michael Michaely, and Armeane M. Choksi, eds. *Liberalizing Foreign Trade: Lessons of Experience in the Developing World*, 7 vols. Washington, D.C.: World Bank, 1991.

Podgursky, Michael. "Estimated Losses Due to Job Displacement: Evidence from the Displaced Worker Surveys." Paper prepared for the Economic Policy Institute, Washington, D.C.: April 1991.

"Response to Issues Raised in Connection with the Negotiation of a North American Free Trade Agreement," Executive Summary, May 1, 1991.

Rothstein, Richard. *Keeping Jobs in Fashion: Alternatives to the Euthanasia of the U.S. Apparel Industry*. Washington, D.C.: Economic Policy Institute, 1989.

Sanderson, Susan Walsh. *The Consumer Electronics Industry and the Future of American Manufacturing*. Washington, D.C.: Economic Policy Institute, 1989.

Schoepfle, Gregory K. "U.S.-Mexico Free Trade Agreement: The Maquilazation of Mexico?" Bureau of International Labor Affairs mimeo, U.S. Department of Labor, April 18, 1990.

Stanford, James O. "C.G.E. Models of North American Free Trade: A Critique of Methods and Assumptions." Testimony to the U.S.I.T.C. Public Hearing on Economy-Wide Modeling of the Economic Implications of Free Trade Investigation No. 332-317, April 1992.

U.S. Department of Commerce, International Trade Administration. *U.S. Exports to Mexico: A State-by-State Overview, 1987-90*. Washington, D.C.: U.S. Government Printing Office, 1991.

U.S. Department of Labor, Bureau of Labor Statistics. *Displaced Workers, 1981-85*. Bulletin no. 2289, Washington, D.C.: U.S. Government Printing Office, 1987.

U.S. International Trade Commission. *The Likely Impact on the United States of a Free Trade Agreement with Mexico*. USITC Publication 2353, Washington, D.C.: U.S. Government Printing Office, 1991.

U.S. International Trade Commission. *Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico*. USITC Publication 2516, Washington, D.C.: U.S. Government Printing Office, May 1992a.

U.S. International Trade Commission. *Economy-Wide Modeling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico: Addendum*. USITC Publication 2508, Washington, D.C.: U.S. Government Printing Office, May 1992b.

Whalen, Christopher. "Mexico's Government Creates Another Debt Crisis." *Wall Street Journal*, March 12, 1992, p. A13.